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No. 85-599

IN THE

Supreme Court of the United States

OCTOBER TERM, 1985

UNITED STATES OF AMERICA,
Petitioner

v.

AMERICAN BAR ENDOWMENT,
Respondent

UNITED STATES OF AMERICA,
Petitioner

v.

FREDERICK D. TURNER *et ux.*,
ARTHUR M. SHERWOOD *et ux.*,
FREDERICK G. BOYNTON and
HERBERT C. BROADFOOT, II *et ux.*,
Respondents

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Federal Circuit

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RESPONDENTS' BRIEF IN OPPOSITION

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QUESTIONS PRESENTED

1. The appropriate question as to the American Bar Endowment is as follows:

Whether policyholder dividends assigned to the Endowment, a section 501(c)(3) charitable organization, by its insured members in a group insurance program constitute income from an unrelated trade or business when the United States Claims Court found as fact, and the United States Court of Appeals for the Federal Circuit agreed, that such dividends were *not* income earned by the Endowment from the "sale of goods or the performance of services," but, to the contrary, were received by the Endowment in a charitable fundraising activity approved of and controlled by the well-informed membership of the Endowment?

2. The appropriate question as to the four individuals claiming a charitable contribution deduction is as follows:

Whether the Federal Circuit correctly remanded the cases of the four individual insureds to the Claims Court for a determination of whether a charitable contribution deduction was appropriate in light of "all the pertinent circumstances" involving the relationship between the four insured members and the Endowment, including the motivation and intent of each individual claiming a charitable deduction?

STATEMENT REQUIRED BY RULE 28.1

The American Bar Endowment is a non-stock membership corporation. Its membership consists of all members in good standing of the American Bar Association. It has no parent and no subsidiaries.

The individual insureds and their spouses who are respondents in this Court are: Frederick D. Turner and Margaret S. Turner, Arthur M. Sherwood and Karen H. Sherwood, Frederick G. Boynton, Herbert C. Broadfoot, II and Nancy L. Broadfoot.

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RESPONDENTS' BRIEF IN OPPOSITION

Respondents American Bar Endowment ("ABE" or "Endowment") and Frederick D. Turner, *et al.* (also referred to as "individual insureds") respectfully request that the Petition for Writ of Certiorari to the United States Court of Appeals for the Federal Circuit be denied.

OPINIONS BELOW

The Government failed to append to its Petition the two oral opinions of the United States Claims Court, despite the fact that Chief Judge Kozinski viewed them as part of his opinion [1] and the parties had reproduced

[1] "The court made oral findings of fact on the record after trial. This opinion supplements those findings as appropriate to the resolution of the legal issues discussed." (P. App. 26a n.1)

each as an "oral opinion" of the Claims Court in the Joint Appendix filed in the Federal Circuit. (C.A. App. 763-825) The oral findings with respect to the Endowment, delivered at the close of trial on November 11, 1983, are set forth in Appendix A to this Opposition ("App. A"); those with respect to the individual insureds, delivered at a status call on December 21, 1983, are set forth in Appendix B ("App. B").[2]

STATUTES INVOLVED

The Government failed to note that section 170 of the Internal Revenue Code of 1954 is involved in this Petition. The relevant portions of section 170 are set forth in Appendix C.

STATEMENT OF THE CASE

Introduction

The Government, in its Statement of the Case, omits critical facts and obscures others; the Petition does not contain "all that is material to the consideration of the questions presented." (Rule 34.1.(g)) Specifically, the Petition fails to apprise this Court of the fact that, after a hotly contested trial nearly four weeks in length that addressed numerous disputes of material fact involving 25 witnesses and hundreds of exhibits, the Claims Court entered specific findings of fact resolving against the Government the key factual issues presented to it. The Claims Court's findings of fact were not challenged by the Government before the Federal Circuit and were unanimously confirmed by that court. It is not feasible or even appropriate in this Opposition to present a comprehensive review of the factual findings. Our supplementary statement attempts to highlight the important elements underpinning the opinions below.

[2] The following additional abbreviations are used in this Opposition: "C.A. App." refers to the Joint Appendix filed with the Federal Circuit; "P. App." refers to the Appendix to the Petition ("Pet.").

Supplementary Statement

A. The ABE Charitable Fundraising Plan

In the 1950's, the Endowment, at the suggestion of the American Bar Association ("ABA"), undertook a novel charitable fundraising plan through a group life insurance program that was designed to generate sufficient contributions to enable the ABE to further its charitable objectives. (P. App. 26a-27a) As an integral feature of the charitable fundraising plan and as a condition for participation, Endowment members agreed to assign their proportionate share of policyholder dividends as contributions to the Endowment. (P. App. 32a)

The insurance offered through the Endowment's program is professional association group insurance—a new concept in 1955 but a common one today. (P. App. 35a; C.A. App. 236-37, 243-44) Such plans are generally used to provide low cost insurance as a service to members. (P. App. 38a) For example, both the medical and engineering professions provide their members with low cost group insurance by this method. (C.A. App. 256-57, 267-70) Under such an arrangement the association serves as the group policyholder. One or more insurance companies underwrite the plans of insurance, and there may be a broker or agent of record. The necessary administration of the insurance program is accomplished by the association and/or by a third party administrator; on some plans the insurance company provides administrative services. (C.A. App. 253-56, 319-20)[3] Pol-

[3] During the years in issue, New York Life and Mutual of Omaha were the insurers for the life and accident and health insurance programs, respectively, and the Endowment employed a licensed insurance broker (James Group Service, Inc.) which received a negotiated commission from the insurance companies for its serv-

icyholder dividends paid by the insurance company (which are unnecessary insurance premiums (Pet. 3)) normally are returned tax free to the members of the association either in the form of a cash distribution or a credit toward future premiums.

The Endowment's plan, however, is different from other professional association plans. Participating ABE members pay premiums much higher than necessary to obtain the insurance coverage; they allow policyholder dividends resulting from the excess premiums to be retained by the Endowment (after the expenses of administering the plan are deducted) and used for charitable grants in the field of law. (P. App. 32a-33a, 36a-40a)[4] Although there was a factual dispute at trial as to the origin, purposes and nature of the Endowment's insurance program, the Claims Court resolved this dispute, finding that the program was devised as a means for charitable fundraising and "has been so presented and perceived from its inception," and further finding that the Endowment has "stubbornly adhered to the original concept that its plans are exclusively for fundraising." (P. App. 35a-36a)

The Claims Court found as a fact that the Endowment did not function either as an insurer or as a broker. Despite the Government's repeated assertions to the con-

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ices. (P. App. 3a-4a, 27a) The Endowment administered the insurance program. (P. App. 4a)

[4] At the time of trial, the Endowment had made grants totaling over $63 million to recipients including the American Bar Foundation, the ABA Fund for Public Education, the Institute for Judicial Administration, the Institute for Court Management, the National College of District Attorneys, the National Council of Juvenile and Family Court Judges, the National College of Criminal Defense Lawyers, the National Institute for Trial Advocacy, and the National Legal Aid and Defender Association. (C.A. App. 116-17) In its fiscal years 1979, 1980 and 1981, the Endowment made grants totaling $3,602,462, $4,397,619, and $4,640,000, respectively. (C.A. App. 117)

trary, the Court found that the Endowment did not sell insurance. (P. App. 27a, 47a) The Government contended at trial that the Endowment, purportedly acting as a "middleman" or a "retailer", received payments of some sort from the insurance carriers for services rendered, but the Claims Court rejected this argument and expressly found that the policyholder dividends came from the members:

> All of the evidence on both sides makes it clear that the money here came from premiums, that no matter what the flow of dollars the economic reality was that these were the members paying money to the association and not insurance companies paying the group in some fashion.

(App. A-12) The Claims Court found as fact that the amounts received by the Endowment did not constitute income "from the sale of goods or the performance of services":

> The amount of money ABE is permitted to retain far exceeds the value of any service it may be providing through the operation of the insurance programs. It is quite obvious, then, that this money was *not earned "from the sale of goods or the performance of services," 26 U.S.C. § 513(c) (1976), but for some other reason. That reason was the intent of the members to support the Endowment's charitable activities.*

(P. App. 41a) (Emphasis added.)

The Government did not challenge this finding before the Federal Circuit, ignoring it there as it has ignored it here. Even so, the Federal Circuit reviewed the evidence of record and confirmed the findings of the Claims Court, remarking that "the Claims Court specifically and permissibly rejected the Government's contention that the dividends represent a payment for the Endowment's services." (P. App. 11a)

The Claims Court found that the significant policyholder dividends generated by the interaction of the excellent mortality and morbidity experience of Endowment members, together with the decision to set premiums at levels significantly higher than necessary, reflected the charitable fundraising strategy of the Endowment *and the expectations of the ABE membership.*[5] In other words, the ABE membership wanted the program to work as it did and wanted the dividends to remain with the Endowment for charitable purposes. (P. App. 35a-40a; App. A-9)[6]

Despite the Government's attempts at trial to prove the contrary. the Claims Court explicitly found that ABE members were fully and fairly informed in a variety of ways as to the charitable purposes of the insurance program:

[5] The Government's repeated characterization of policyholder dividends assigned to the Endowment by insured members as "income" and "profits" begs the question. The trial in this case was directed to the factual dispute as to whether such dividends constituted "income" or "profits" from the sale of goods or the performance of services or whether there was another explanation, namely, the intention of the membership to allow the Endowment to retain the dividends (after deducting the expenses of administering the program) for charitable purposes. On the basis of the evidence at trial, the Claims Court found that the latter explanation was the correct one. (P. App. 40a-41a)

[6] ABA/ABE members could have decided to retain the benefit of their favorable mortality and morbidity for themselves. The Court found (P. App. 38a), however, that ABA/ABE members affirmatively chose not to pocket the dividends but to dedicate them to charity:

> If the ABA had chosen to do this, it could have offered its members insurance at premiums lower than any other bar association, perhaps the lowest premiums of any group in the country. The ABA members, however, have chosen a more generous approach, allowing the Endowment (rather than the ABA) to operate the insurance program and retain the dividends.

> [The Endowment] disclosed the relevant facts to its members at every available opportunity, yet the members (who bore the economic cost of this program) allowed the practice to continue although they collectively had the power to change it.

(P. App. 40a; App. A-7 - A-9)[7] The Claims Court also found as a fact, again contrary to the Government's assertions at trial (P. App. 39a), that the attitude of the ABA/ABE leadership toward the program reflected the views of the membership and that, if the members had wanted to discontinue the charitable feature and retain the dividends for themselves, the leadership would have responded by implementing those wishes:

> Plaintiff has demonstrated to the court's satisfaction that there are ample, effective channels within the ABA for members to make their views known *and have them implemented.*

(P. App. 39a-40a & n.9) (Emphasis added.)[8]

B. The Individual Insureds

The Government ignores the fact that the brief testimony of the individual insureds in support of a deduction was supplementary to and based upon *all* of the testimony at trial concerning the relationship of the Endowment

[7] The Court found that "both the ABE leadership and the insured members considered the insurance program a fundraising activity and treated it as such." (P. App. 36a) "Most professional associations (including almost all bar associations) operate such programs on a service-oriented basis and secure the most economical group insurance for their members." (P. App. 38a) "The money that could have been saved by the members who bought insurance was equal to the dividends refunded minus the Endowment's operating expenses. This amounted to several million dollars a year." (P. App. 38a n.7)

[8] Wm. Reece Smith, Jr., a former President of the ABA and of the Endowment, testified at length concerning the governance of the ABA and ABE. (C.A. App. 198-211) He and other ABA and ABE leaders noted the lack of dissent within the ABA concerning its support of the Endowment's program. (C.A. App. 188-89, 221-24)

members to the insurance program. In addition, in purporting to summarize the testimony of the individuals, the Government disregards highly pertinent, particularized evidence of charitable motivation.

Arthur M. Sherwood, as a member of the New York State Bar, had carried New York State Bar sponsored life insurance but dropped it before the taxable years involved here. He understood that the ABE program was charitable and that the (significantly cheaper) New York plan was not. Mr. Sherwood annually received notices (as did all insured members) from the Endowment informing him of the portion of his premium that was a contribution to the Endowment. He testified that he intended and expected that a substantial portion of his ABE premium would go to charity. (C.A. App. 413, 415-18)

Herbert C. Broadfoot testified that he believed he was making a dual payment: "One component is the insurance coverage aspect of it, and another component is the contribution that I am making to the American Bar Endowment." (C.A. App. 395) Although it was cited in our brief to the Federal Circuit, the Government overlooked the following testimony by Mr. Broadfoot:

> . . . I was advised by the insurance agent I consulted that the American Bar Endowment insurance program was more costly than the same coverage at his company or at other insurance companies. However, he recognized the contribution feature of this insurance coverage. That really was what we discussed when we reviewed the program.

(C.A. App. 393-94)

SUMMARY OF ARGUMENT

The contention by the Government that the Federal Circuit's decision in the Endowment's case conflicts with decisions of other Courts of Appeals is without merit. The decisions of other courts relied upon by the Government are based on findings of fact that the dollars there

in question were received by business leagues from insurance companies *in exchange* for the performance of services for such companies. The small percentages of premiums received by those associations were found by the Claims Court to be "well within the range normally paid for those types of promotional and administrative services." (P. App. 44a) The legal question addressed by those courts—whether earnings from those services nevertheless did not constitute "business" income because they lacked the requisite profit motive—does not arise in the Endowment's case. Here the Claims Court found and the Federal Circuit confirmed that the policyholder dividends the Government would tax were not income that the Endowment earned from the sale of goods or the performance of services. Instead they were attributable to the generous decision of Endowment members to support a charitable fundraising effort by allowing the Endowment to retain the dividends. Accordingly, such dividends cannot be unrelated business income.

None of the other reasons advanced by the Government for granting its Petition is meritorious. Without admitting it, what the Government is seeking from this Court is a reversal of the findings of fact on which both decisions below are based.

As to Messrs. Turner, *et al.*, the Federal Circuit has entered an interlocutory order remanding the four cases to the Claims Court for further proceedings. The Claims Court was instructed to determine if a charitable contribution deduction is appropriate for each of the four individual insureds in light of "all the pertinent circumstances" (P. App. 21a) involving the relationship between the four insured members and the Endowment, including evidence of the motivation and intent of each individual claiming a charitable deduction. No reason exists to grant the Petition; the Federal Circuit, in remanding for further proceedings, did so on the basis of traditional principles of tax law which do not conflict with any decided cases.

REASONS FOR DENYING THE WRIT

I. The Unrelated Business Income Issue

1. While the Petition repeatedly accuses the Federal Circuit of refusing to apply the appropriate statutory standard, in reality it is the Government which cannot afford to (and therefore never does) apply the statutory standard to the facts found below. The Endowment can be taxed only to the extent it realizes "unrelated business taxable income," which in pertinent part is defined by section 512(a)(1) of the Internal Revenue Code as—

> the gross income derived by any organization from any unrelated trade or business (as defined in section 513) . . . less the deductions allowed . . . .

(P. App. 63a) A "trade or business" is defined by section 513(c) as "any activity which is carried on for the production of income *from the sale of goods or the performance of services.*" (P. App. 67a) (Emphasis added.) Absent a finding that an activity was carried on by an exempt organization (1) to produce income and (2) that such income was from the sale of goods or the performance of services, there cannot be a finding that the Endowment engaged in a trade or business.

The Petition asserts that the Endowment's "operations obviously comprised both 'the sale of goods' and the 'performance of services,'" and implies that these activities were the reason the Endowment was able to retain the dividends that the Government would tax. (Pet. 17-18)[9] However, both courts below rejected the Government's

[9] In the past the Government had flatly conceded that the Endowment does not "sell insurance." (C.A. App. 95) This inconsistency is not surprising since throughout this litigation the Government has not been able to make up its mind as to who paid the Endowment the millions of dollars it would tax, or to fix on a logical explanation of what the Endowment has done—year in and year out—to realize its "profit" (over $63 million cumulatively) on the administration of a single group insurance program.

contention that dividends were paid to the Endowment by insurance companies or Endowment members in return for the sale of goods or the performance of services by the Endowment. (*See* P. App. 9a-12a, 35a-41a) The Claims Court concluded that the Endowment did not receive one penny of compensation from an insurance carrier for any reason and held unequivocally that the members of the Endowment did not assign dividends to the Endowment in exchange for the sale of goods or the performance of services.[10] Rather, it was the "intent of the members to support the Endowment's charitable activities" that caused the members to permit the Endowment to retain $63 million in dividends for charitable purposes (P. App. 41a), and, as the Federal Circuit explained, the Claims Court "determined that the Endowment's receipts have far exceeded the value of any services which it might have performed in the course of its administration of the plan, and thus did not fit within the statutory definition of income from a trade or business." (P. App. 8a-9a)[11]

[10] The Government would characterize the relationship of the ABE and its insured members as one where the Endowment bought insurance wholesale and sold it to the members retail. (Pet. 17, 25) This is in sharp contrast to the findings of the Claims Court and the analysis of both courts below. New York Life and Mutual of Omaha sold the insurance and the premium payments were made by the members. In the usual service-oriented plan the dividends, after expenses, would have been returned to the members or applied for their benefit. The price to such members, after dividends, is in no sense a wholesale price. It is the price of a particular insurance product, namely, participation in an association group insurance program. The generosity of Endowment members in giving up their policyholder dividends returned by the insurance carriers does not make the "wholesale-retail" concept valid.

[11] The amounts the Government would tax as unrelated business income during the years in issue are five to seven times the fee (including a normal profit) that would have been charged by a third party administrator for performing the same services in those years. (C.A. App. 138-39, 373-74, 468-71, 582, 734-35, 1173-84)

2.a. The Government asserts that the decision of the Federal Circuit "squarely conflicts" (Pet. 12) with three cases from other circuits which allegedly arise "on substantially identical facts" as the Endowment's case. (Pet. 13)[12] Only by ignoring the unique facts of this case can the Government make such an assertion. In the trade association cases relied on by the Government, there was no question that the sums involved were received "from the performance of services." Each of those associations performed services for an insurance carrier and was paid a fee in the form of a small percentage of premiums by the insurance carrier for the performance of services.[13]

The principal unrelated business income issue in *Professional Insurance Agents* concerned a percentage of premiums paid to PIA by insurance carriers for its activities in connection with several different group insurance programs that it endorsed. 78 T.C. at 256. These payments were made by insurance carriers *in return for services rendered to them.*[14] For example, one agreement

[12] *See Professional Ins. Agents v. Commissioner*, 726 F.2d 1097 (6th Cir. 1984), *aff'g*, 78 T.C. 246 (1982); *Carolinas Farm & Power Equip. Dealers Ass'n v. United States*, 699 F.2d 167 (4th Cir. 1983), *rev'g*, 541 F. Supp. 86 (E.D.N.C. 1982); *Louisiana Credit Union League v. United States*, 693 F.2d 525 (5th Cir. 1982), *aff'g*, 501 F. Supp. 934 (E.D. La. 1980).

[13] As noted by the Claims Court, the associations received percentages of premiums which were "well within the range normally paid for those types of promotional and administrative services, [and] stand in stark contrast to the 40, 50 and even 90% of premiums regularly refunded as dividends and retained by ABE." (P. App. 44a-45a)

[14] PIA also retained an "experience rating reserve" (which is not a dividend) that it received when one of the programs it endorsed was terminated. Although PIA agreed to be responsible for distributing this fund to its members, it never did so and there is no indication that PIA members knew that PIA had received and retained this fund to which they were arguably entitled. 726 F.2d at 1100-01.

with an insurance company indicated that PIA would "'perform certain services on behalf of'" the insurance company. 726 F.2d at 1100. The agreement further recited that *because* the services were performed on behalf of the insurance company, the association was to be reimbursed with a service fee of 6% of premiums. A 4% fee received by PIA in connection with another policy was said by the Sixth Circuit to be "[i]n return for its promotional efforts." *Id.*

In analyzing whether PIA was conducting a trade or business, the Sixth Circuit appropriately focused on the phrase "carried on for the production of income", since it was clear that the fees received were derived from the performance of services. The court asked "whether PIA has engaged in extensive activity over a substantial period of time with intent to earn a profit." *Id.* at 1102. Since the record reflected a profit motive, the tax was imposed.

The other cases are to the same effect. In *Louisiana Credit Union League*, the business league received a flat percentage of both initial and renewal premiums on insurance policies in return for "services which the League performs." 501 F. Supp. at 938. The Fifth Circuit rejected the argument that the fees derived from services were not income from a trade or business, noting that the League's contracts with the two companies indicated that the revenue was "*earned*" (emphasis in original) by virtue of the League's activities on the carrier's behalf, 693 F.2d at 531, and such activities were engaged in "over a substantial period of time with the intent to earn a profit." *Id.* at 532.[15]

In *Carolinas Farm & Power Equip. Dealers Ass'n*, the association received in exchange for services an "admin-

[15] These fees were in the form of commissions on insurance premimums and ranged from 2½ percent to 7½ percent. 501 F. Supp. at 936.

istrative allowance" from the insurance company in the amount of 7% of premiums. 541 F. Supp. at 88. The Fourth Circuit held that the plain language of the statute should control and that an activity is a trade or business "if an exempt organization conducts it for the production of income from the performance of services." 699 F.2d at 170.[16]

Thus, in all three trade association cases, there was no question that the income received was derived from the performance of services. The money was received from the insurance companies as fees for services rendered and the amounts received were consistent with the market value of the services. There was no suggestion in these cases that income was the result of a charitable fundraising program. The facts of these three cases and the legal analysis required by their particular facts present a stark contrast to the facts and legal analysis pertinent to the Endowment's case.[17]

b. The Government argues that the Federal Circuit, in finding the business league cases inapposite, "relied principally on the fact that the associations marketing the insurance there were organized as '[b]usiness leagues' exempt from tax under Section 501(c)(6), rather than as charitable or educational associations exempt from tax (as is the Endowment) under Section 501(c)(3)." (Pet. 14)

The Government misperceives the distinction drawn by the Claims Court between the section 501(c)(6) trade

[16] The association also received experience refunds (dividends) on its program. However, since these were passed back to the members, no unrelated business income tax was asserted by the IRS with respect to these funds. 541 F. Supp. at 88.

[17] The Federal Circuit, after stating succinctly that "[a] charity should not be subject to taxation merely because its charitable solicitations are successful," pointed out that this would be the result "if we adopted the IRS' reasoning in this case." (P. App. 12a)

association cases and the Endowment's case. In the former, the courts were not presented with facts where it was necessary to distinguish between the "profits" of a business enterprise and the successful result of an effort to solicit charitable contributions. In the broadest sense every charity seeks to maximize the "profits" from its charitable fundraising; this does not mean that in every case the existence of "profit" is the equivalent of income derived from the sale of goods or the performance of services.[18] That is why a trial was required in this case to determine whether the Endowment was running a business, and the Endowment's position prevailed. The dividends assigned by insured members to the Endowment are the fruits of a charitable fundraising effort and are not an exchange for goods sold or services rendered.

The Government also ignores the fact that the Federal Circuit relied upon the specific statutory language of section 513(c) as an independent ground for distinguishing these cases:

> We note an additional ground for distinguishing these cases: the business leagues received a stipend from the insurance companies for services provided to these companies, and not merely experience dividends which their members allowed them to keep. Their profits therefore fell within the definition of "trade or business" ("income from the . . . performance of services") contained in section 513(c).

(P. App. 10a)[19] Neither decision below stands on the proposition that a section 501(c)(3) organization and a

[18] The Government's expert economist, Dr. Plotkin, testified that the maximization of revenue or profits "absolutely" did not provide a basis for distinguishing between charitable fundraising and business profits. Further inquiry was required to determine whether the funds derived were the product of a business or a charitable fundraising effort. (C.A. App. 695-97) That is precisely the question answered by the Claims Court in this case.

[19] Similarly, the Claims Court determined that the trade association cases "are also distinguishable factually," finding that each

section 501(c)(6) organization are to be treated differently for purposes of section 513 *if they are operating in the same manner.* Certainly the Endowment has never made any such contention. The statutory definition of a trade or business should be applied to each exempt organization and that is precisely what the Claims Court and Federal Circuit did in this case.[20]

3. The Government's unsupported assertion that the Endowment's case has significant administrative importance should also be rejected. The record at trial did not disclose that the members of any other professional association knowingly chose to donate millions of dollars to charity that they concededly could have caused to have been returned to themselves tax free.[21] Thus, it is hard to suppress skepticism at the Government's unsupported contention that hordes of members of tax-exempt organizations are now prepared to follow the practice of the members of the Endowment—which has been widely publicized for many years—and remove from their pockets dollars they have historically kept in order to donate that money for charitable uses. But if they are, they should be encouraged, in keeping with the policy of the tax laws, to donate their dividends for public charitable purposes rather than retaining them for private

association received consideration for services rendered (P. App. 44a-45a) and that "none of the cited cases suggest that members were fully informed of the arrangement with the insurance company and permitted it to continue even though it caused them a monetary loss." (P. App. 45a)

[20] In addition, no one has ever contended that a "destination" of income test had any relevance to this case. (Pet. 15-16) The opinions below do not embrace any such test.

[21] The Government disingenuously suggests that the administrative importance of this case is buttressed by the fact that most state bar associations sponsor insurance programs. (Pet. 20) The Petition fails to note that state bar programs operate "on a service-oriented basis and secure the most economical group insurance for their members." (P. App. 38a)

gain. This possibility provides no reason for granting the Petition.

4. In belittling the Federal Circuit's opinion as "whimsical" (Pet. 18), the Government chooses not to mention that the Internal Revenue Service on two occasions (1972 and 1973) ruled that the dividends received and retained by the Endowment did not constitute unrelated business income. The Claims Court, however, noted the Service's change of position:

> It is also not without significance that for 21 years the Internal Revenue Service took the position that ABE's operation of the insurance program was not taxable. *See* IRS Letter Ruling 8042012 (July 3, 1980) (citing unpublished technical advice memorandum of January 31, 1973, that concluded ABE's insurance program was not a business). This suggests that whatever UBIT policies the ABE's activities are thought to implicate must be subtle indeed. [P. App. 46a] [22]

5. The Petition asserts as a reason for granting certiorari that *United States v. American College of Physicians, cert. granted,* No. 84-1737 (July 1, 1985), "is related" and "is connected" to this case. (Pet. 12, 21) In fact, the only relationship between the two cases is that both involve the same section of the Internal Revenue Code. Otherwise, as the Petition itself demonstrates, the two cases have nothing in common. *American College* raises *only* the question of whether a tax-exempt organization's income from "commercial advertising, which it concedes to be a 'trade or business,' is 'substantially related' to educational purposes" (Pet. 21), a question on

[22] The Federal Circuit observed that its "refusal to view the recouped dividends as payment for the Endowment's services is consistent with the IRS' own memoranda" explaining when the imposition of the unrelated business income tax is called for and when it is not. (P. App. 12a n.6)

which the lower courts disagreed. In this case, the Government correctly noted that the Endowment conceded that its insurance program was not "substantially related" to its exempt function. (Pet. 5)

American College presents a totally different issue from the unanimous fact-specific decision in the Endowment's case. The Government itself acknowledges that *American College* "is most unlikely to resolve the question of statutory construction presented here." (Pet. 22) As we demonstrate above, there is no "question of statutory construction presented here" if one deals forthrightly with section 513 as written by Congress and applied by the Claims Court and the Federal Circuit. In any event, the fact that *American College of Physicians* (or any other case on the Court's docket for that matter) will *not* govern this case hardly constitutes a reason for granting the Petition.

II. The Charitable Contribution Issue

1. The Petition states that the Federal Circuit "stayed proceedings on remand pending disposition of this petition." (Pet. 11) This statement is an incomplete explanation of the interlocutory posture of the cases of the individual insureds. A brief review of the decisions below will help to clarify the present posture. The Claims Court declined to take an approach that would afford a deduction for all Endowment insureds, but instead promulgated a test focused solely on the fair market value of *different* insurance. The Federal Circuit concluded that the Claims Court's unitary test was too rigid, in that it failed to take into account all the facts and circumstances bearing upon the motivation and intent of individual insureds (P. App. 19a-22a) and thereupon remanded for "an examination of all the pertinent circumstances surrounding the individual transaction," including direct evidence of the motive and intent of each individual insured, to determine whether a contribution was appropriate. (P. App. 21a)

When the Government failed to seek a stay in the Federal Circuit and the individual insureds requested that proceedings on remand be instituted, Chief Judge Kozinski repeatedly urged the Government to allow the proceedings on remand to be completed so that a full record could be presented to this Court, with no delay in the filing of the Petition.[23] Refusing to allow this to happen, the Government appealed Judge Kozinski's denial of its motion for a stay, and the Federal Circuit then granted the stay. Presumably, the Government concluded that a final judgment in these cases, entered after an evidentiary hearing as to the charitable motivation and intent of the individual insureds, would not enhance its chances for certiorari. Certiorari is inappropriate at this interlocutory stage of the proceedings.

2. The Government ignores the Federal Circuit's discussion of the dual payment concept, which is at the heart of that court's analysis of the charitable contribution issue.[24] Under recognized principles governing charitable deductions in such instances, the donor must show that his or her payment was significantly in excess of the economic benefit received—the so-called *quid pro quo*. The Government disregards the significance of the findings below that the dividends assigned to the Endowment were in such amounts as to be "wholly unrelated" to the value of any services conceivably rendered by the Endowment. It argues, curiously, that this "staggering"

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[23] Transcript of June 27, 1985 status call at 9-13, 23; Transcript of July 3, 1985 status call at 17-19.

[24] In asking this Court to overturn the dual payment decision below, the Government does not mention its own rulings which recognize a charitable contribution in a situation where a payment is made in anticipation of *both* an economic benefit and a charitable contribution. *See, e.g.*, Rev. Rul. 68-432, 1968-2 C.B. 104 and Rev. Rul. 67-246, 1967-2 C.B. 104.

amount of "profit" is evidence of a business motivation. In fact, in the context of a charitable fundraising program, what this receipt of disproportionate dividends demonstrates is a dual payment, part for an economic benefit and part for charity. Endowment members have parted with dollars that would otherwise have been returned to them; since a gift has been made with adverse economic consequences, the Federal Circuit properly held that an insured member should be entitled to demonstrate entitlement to a deduction by proving that he or she had made a dual payment.

3. The Government appears to claim that the individual insureds' cases are in conflict with *Sedam v. United States*, 518 F.2d 242 (7th Cir. 1975); *Stubbs v. United States*, 428 F.2d 885 (9th Cir. 1970), *cert. denied*, 400 U.S. 1009 (1971); and *Singer Co. v. United States*, 449 F.2d 413 (Ct. Cl. 1971). A proper analysis of these cases, however, shows that the Federal Circuit's decision is consistent with each.

In *Sedam*, the taxpayer claimed a charitable contribution deduction for payments made "in consideration" for a nursing home admitting his mother as a resident. 518 F.2d at 245. The court stated that "a payment is not a contribution or gift under section 170 if it is made with the expectation of receiving a *commensurate* benefit in return . . . ." *Id.* (Emphasis added.) There was no contention by the taxpayer that a dual payment was made. He had deducted the entire payment. The Government, in relying on *Sedam*, does not deal with the fact that the Federal Circuit applied the same standard in this case (P. App. 13a-15a), nor does the Petition come to grips with the significance of the key word "commensurate" as it applies here.

In this case, the individual insureds have contributed dividends to the Endowment for charitable purposes for which they received nothing in return. The amount of

the charitable contribution was calculated *after* the insurance companies had been paid for providing the insurance coverage at prices negotiated at arms' length, *after* the broker had been paid its negotiated commission and *after* payment of the Endowment's expenses of administering the insurance program had been deducted from the dividends. In other words, after establishing the full and fair value of the benefit a member received for his premium dollars, *there was a significant amount of money left over*, which the insured members allowed the Endowment to retain for its charitable purposes.

The suggestion that *Singer Co.* conflicts with the Federal Circuit's opinion is somewhat surprising in view of the fact that the Federal Circuit *relied* upon *Singer*. (P. App. 15a-18a) In *Singer*, the taxpayer expected that sales of sewing machines to schools at less than market prices would increase future retail sales. A deduction was denied because the taxpayer failed to show that the fair market value of the anticipated economic benefit was less than the discount given to the schools. 449 F.2d at 420, 423-24.

Stubbs was a jury case in which the question was whether a landowner could deduct as a charitable contribution the value of land dedicated as a public road. The issue of a *quid pro quo* was put to the jury, which apparently believed the prior inconsistent testimony of the taxpayer at a hearing before the Zoning Commission that he would receive by reason of the transfer an offsetting economic benefit to an adjacent property. 428 F.2d at 887 n.1. As in *Sedam*, there was no contention that there was a dual payment.

4. The Government erroneously argues that the Federal Circuit's decision has in some way altered traditional principles of burden of proof applicable in tax refund cases by stating that such burden would shift to the Government on the deductibility issue upon presentation of a

prima facie case. The Federal Circuit's opinion says no such thing. Nor does the Federal Circuit suggest a "self-serving affidavit" as an appropriate way to proceed. (Pet. 24-25)

The Federal Circuit applies well-recognized concepts of shifting evidentiary responsibilities at trial to the particular circumstances of this case. It outlined those elements which for certain members would constitute a *prima facie* case for sustaining the charitable contribution deduction.[25] A *prima facie* case, of course, is that minimum quantum and quality of proof which, if unrebutted, would entitle the proponent to a judgment on his claim. Once the taxpayer has presented a *prima facie* case, it is only the burden of going forward with additional evidence to rebut that case which shifts to the Government. If the Government discharges its responsibility of coming forward with rebuttal proof, the taxpayer is still required to establish by a preponderance of the evidence his entitlement to the claimed deduction. This process is all that the Federal Circuit decision envisions, and nothing in its opinion offends any notion regarding the burden of persuasion in tax or other civil cases.

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[25] The Government does not mention that the Federal Circuit also outlined other elements on the basis of which a "trial court might reasonably conclude" that "the taxpayer should be denied a deduction." (P. App. 21-22a)

CONCLUSION

The petition for writ of certiorari should be denied.

Respectfully submitted,

/s/ Francis M. Gregory, Jr.

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Dated: November 7, 1985

APPENDICES

APPENDIX A

IN THE UNITED STATES CLAIMS COURT

No. 465-82T

AMERICAN BAR ENDOWMENT,
Plaintiff,

v.

THE UNITED STATES,
Defendant.

TRANSCRIPT OF ORAL OPINION
OF CHIEF JUDGE ALEX KOZINSKI
ON NOVEMBER 11, 1983

THE COURT: Okay thank you very much. I am going to take a little break and come back with as much of a decision or perhaps an entire decision, as I can make today.

(A brief recess was taken.)

THE COURT: Please be seated.

I am going to decide Case Number 465-82T, the case of the American Bar Endowment versus the United States, in favor of the American Bar Endowment, the Plaintiff.

I have sat through three and a half weeks of trial, and have had an ample opportunity to observe witnesses, and to absorb their testimony and I have looked at as many documents as I think could [profitably] * be looked at. And the reason I am deciding that case in favor of the American Bar Endowment is that I have determined that

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* Brackets indicate a correction required in the transcript.

this is not a business and is not making a profit from its enterprise.

Now, Dr. Plotkin suggested several smell tests that can be employed for that purpose, and I suppose I have used my own smell test as well as the facts.

The first factor, and one which ought not to be at all underestimated in importance, is the way the program is billed, the way it is advertised, the way it is presented, the way it is operated. The program is presented to the world and to the members in a very open fashion, as a charitable program, as a means of fundraising.

That is not determinative. The fact that the program either through subterfuge or through perhaps honest delusion is presented as a fundraising effort or the means to raise charitable funds, is not conclusive, is not binding on the Court; but I certainly think it is well worth considering as one factor.

I may be less skeptical than my brothers and sisters in the field of taxation law, but to me what people say to each other, particularly when large groups of people say it repeatedly to each other and they have a common understanding, makes a difference, makes a starting point. It raises a presumption. Perhaps not a very strong presumption, but one that I think is well worth keeping in mind as a place from which to depart.

Now, in this case we have seen a good deal of advertising and a good deal of literature, a good deal of promotional materials, ABA journal articles, reports, so on, and I find that it was made abundantly clear to the ABA membership and the ABE membership that the insurance programs were a method for fundraising. That was billed as its purpose, and this was communicated in fact to the membership; and one, of course, can never guarantee in a group of 300,000 that each and every member will unmistakably learn the precise purpose, but I find that with perhaps trivial examples, lawyers being well informed,

certainly being able to read, and there was a barrage of literature, barrage of advertising, barrage of reports which over the years should have made it abundantly clear and did make it quite clear that was the billed purpose, that was the way the program was perceived.

I also look in the smell-test category, rather than necessarily the operative fact—and it is a gray area as to where one begins and the other one ends, but I also look at the startling profitability of this group. And it has made a lot of money over the years, it has made $63 million. That tells me two things. One of them is there was a lot of testimony about who else in this general type of enterprise or in this general field has made, or will make or can have made this much of a profit, and I think the evidence is quite clear, and in any case I so find that equivalent profits were only made by what has been described by one witness as the robber scoundrels of the insurance industry who, as I understood Ms. Khachadour and other witnesses to explain, used captive audiences, used very serious pressure tactics, used practices that can [be] viewed as entirely—or could be viewed certainly and have been viewed as unethical and have been made unlawful; such things as a person who wants to get a loan, who may be desperate for a loan, maybe something having to do with his house or who may need the loan for some other personal purpose and may be required as a condition for buying the loan to buy the insurance.

The analogy to those kinds of situations, or to that kind of an enterprise is nonexistent here. To be sure, the American Bar Endowment used advertising and something that conceivably could be viewed as scare tactics, listing the many illnesses that befall man in light of his transgression many years ago with the apple and the snake; and I suppose that is our lot, we have frail bodies and once in a while we do get reminded of the fact that the unfortunate among us can be beset with illness and death.

But that is an entirely different kind of pressure tactic than holding the necessity of a completely collateral nature, such as a loan, car or house loan, or some other transaction, hostage to the purchase of insurance.

So when we look at the question of these great tremendous profits, we have to find some other explanation as to why this particular operation has been so successful in raising funds, and once again here I reveal my lack of skepticism, perhaps, but my feeling is that the obvious explanation sometimes is the one that is correct. You know, if it looks like a duck and quacks like a duck, and you know it leaves droppings on the floor like a duck, then maybe it is a duck. And in this case the explanation that suggests itself to the mind immediately, if indeed the American Bar Endowment were selling its members—"selling," I use loosely the term, was conveying the idea that this was a fundraising enterprise and therefore rates are going to be set in accordance therewith, and that the many millions of dollars that were made from this enterprise were disclosed to the members over the years, and the profitability of the enterprise continued, the suggestion is that maybe members really thought this was a fundraising enterprise, that they were really participating in fundraising and that they tolerated this as consistent with the purpose of the effort.

That is certainly the suggestion that arises in one's minds [sic] when one looks at these factors. Nothing I have seen in this case suggests that that is different. I think it is almost bizarre to suggest that the strong fundraising aspect of the literature and of the approach, of the information conveyed, the fact that the profits, as they are called, or the result of all of these fundraising activities were disclosed and, so to speak, rubbed into the faces of the members, that it would be ignored, that it doesn't exist in reality? I simply have seen nothing in this case that suggests that those factors ought to be not taken into account.

Now, what have we got here? When I started to analyze it, I posed it as hypothesis at various times in the trial, but now I state it as my finding: I think we have a situation where there is a group asset. There is an asset that exists only by virtue of the group.

An individual member does not have a piece of the asset in the sense that he could walk away and pocket it and use it on his own. By virtue of existing as part of a group something more is created, an economic good is created which did not exist outside the group experience. And I am not sure how to characterize this asset or what I ought to call it, but we all know, all of us who have sat here and watched for the last several weeks know the nature of the beast. It is a favorable group rating. It is the ability to bargain well with the insurance company and to get the discounts that go with being an experience rated group.

It has been described in various ways, but what it amounts to is a reality that seems to be, at least as far as this record is concerned, limited to the insurance industry. I don't say some other case might not arise that might involve a similar analogous experience in some other industry, but nothing suggests itself to the mind.

The asset is created by virtue of the fact that it is possible, or so we have learned, to segregate out of the mass marketing of insurance a group that has more favorable morbidity and mortality experience; that enables that group and its members by virtue of group membership to profit from lower rates. Or they could profit from lower rates if they don't do something to stop themselves from so profiting.

And that rais[es] interesting questions. I wish I had had economists to discuss with me—because I am not sure anybody else here likes economists. I know Mr. Gregory is skeptical of them, but I for one enjoy listening to economists and I frequently learn. And what was

somewhat lacking on this record, and what I had to to some extent use my own imagination for is the economics of the group asset. How does one create a group asset, how does one control a group asset, how does one monetize a group asset and the various aspects of group ownership, control and distribution of whatever benefits are involved.

And absent evidence to the contrary it seems to me that an asset that is created by virtue of the existence of the group ought to belong to the group and not to any one individual member, that it is something that the group as a whole must dispose of through normal group processes. It is not, as I said, the type of asset that could be divided up and allow each person to walk away with it, it has to be dealt with in some group fashion, left to be dissipated. It seems to me group processes normally rule by majority and when the group is too large to have absolute majority rule the representative process is the way to dispose of group [assets].

To be sure there are always in the group, as there is in society, those who would deal with group problems in a fashion which is different from the majority. That is the nature of the democratic process and that is the nature of the group process. Any group larger than one has a potential for dissidence. And I don't know what one can do about it. We are all a part of groups and societies; and I don't think there is anybody here who agrees with everything our Government does in every instance, nevertheless it is our Government and it has imputed to us our action, and by the same token the group asset is disposed of by the group. In this case the group has made a decision through its membership, or its leadership to dedicate and devote the group assets for a charitable purpose. And they have chosen a way which in my view is calculated to achieve that result. And by donating the asset in total to the American Bar Endowment and allowing for it to monetize it, to in some

fashion derive from this asset the most benefit that it can for the charitable enterprise.

Now, it should be observed, and I think Dr. Plotkin agreed with me on this, from an economic standpoint the membership by making the decision has uniformly to a person made a contribution in an economic sense; by voting for this group device, for this disposition of the group asset, each and every member has been deprived of the opportunity to participate in a lower-cost insurance program, if indeed the American Bar Endowment were able to set one up.

Now, there have been some last-minute questions raised on that, and I simply cannot believe that after all of the evidence we have seen in this trial about state bars and local bars and county bars setting up group plans that there would be serious question that if the ABA membership with all of the legal talent at its disposal chose to set up a plan that would be simply a service-oriented plan that they could not figure out some way of doing it without losing the tax status of either the ABE or ABA or both.

Now, by making the decision, each and every member is contributing to the joint enterprise by agreeing to forgo the benefits, and they have been pointed out to be substantial benefits, of the much lower service-oriented group insurance.

The question then arises to what degree is there really control over the group. By the group rather, I mean over the program. And that has been raised as an issue. And I simply have seen no evidence at all suggesting that this group is any different from any other group in the ability of members to make their views known to the leadership, and to change the direction taken by the leadership when it is inimical to their understanding and interest.

I said I would take judicial notice of the events that transpired in the D. C. Bar several years ago, and in that case there was a great rift between the leadership of the Bar and the rank and file. There is great evidence that the D. C. Bar thought that the two referendums that were posed, one which would lower dues on the one hand and the other which would limit activities to the Bar, would sound the death knell to the Bar as an institution, that it would render it merely a shadow of its former self, that it was the professional responsibility to engage in other activities, that this was generally a bad idea.

There was no doubt to those of us who are in D. C., certainly not to me when I was here when this was going on, and certainly the materials don't raise any doubt, but that this was a grass roots movement versus leadership of the Bar. And when all was said and done, and when it came down to the economic interests of the Bar members and the few dollars here and the few dollars there, and the dust settled, the members of the Bar spoke loud and clear: They preferred to keep the money themselves rather than engaging in various extraneous Bar-type activities, other than the minimal ones of attorney discipline and the like. D. C. members simply did not want their Bar squandering their money, or at least they viewed it as squandering their money on public spirited types of activities, activities that would enhance the organization.

I have little reason to believe that when $63 million are at stake that the members of the American Bar Association or the American Bar Endowment could not change that policy. Now, again I want to point out that more than $63 million are at stake, because not only is at stake the amount that was actually collected in dividends and premium refunds, but one must also include the economic incentives and the economic benefits lost, all of the benefits that other members of the Bar who chose not to participate in insurance would have gained if only there were a change in the policy. So we are not talking

only about those who buy the insurance and forgo the premiums, but we are also talking about the significant economic incentives that exist for those who do not buy the insurance but wish they could.

I am persuaded that if the American Bar Association Plan were not viewed as a fundraising enterprise and were not viewed by the overwhelming majority of the membership as something to be tolerated as, to be sure, an economic expense but one for the good of the profession, and for the greater good of society, that it would not exist, it could not have existed, it could not have survived, it would not have survived to today. And at least on the basis of this record those are my findings on that point.

I do want to speak a little about the analysis of Dr. Plotkin, whom I certainly enjoyed hearing, and for whom I have a great deal of respect. I questioned him at some length because—well, I couldn't forego the opportunity, and because I guess I had questions that went to the heart of his analysis, or to the manner in which his analysis was constructed, and I wanted to understand what direction he came from.

Now, Dr. Plotkin was quite candid that the analysis that he employed was an industrial organization analysis. It was analysis born of antitrust. Much time is spent by economists wondering whether if one fixes prices everyone will be better or worse off, and as I recall by way of showing on that board—I am sure Mr. Gregory would want to know precisely how that is done—that if you only avoid price fixing there will be more things for more people, and things get more complex from there.

The question I asked myself is how do the underpinnings of industrial organization analysis, antitrust analysis, relate to the question in this case. And the question in this case is a rather more narrow one. We are not dealing with the broad questions of antitrust, those

questions involve very complex issues and very complex policy judgments. We are here dealing with basically the question of whether something is a business or is not a business, whether something is a fundraising activit[y] or not a fundraising activity. We are looking to indices, but by definition that activity has to take place in the market.

And by definition, again from Dr. Plotkin's own statements, that activity, fundraising activity, must displace and must have a ripple effect upon the market in which it operates. It is almost inconceivable to have some activity that one could classify as simply fundraising that does not somehow [a]ffect other transactions in the market and other various structures of the marketplace. And I was interested to find out how those policies, how the things that Dr. Plotkin was taking into account in reaching his conclusion related to what we are talking about here.

I was a little disappointed to understand that Dr. Plotkin, while he was conversant with spaghetti—which is fine, which is really the place where the unrelated business income tax started from—was not as conversant as I well might have hoped with the policies of the unrelated business income tax. To him the fact that if one buys one brand of spaghetti one is less likely to buy another one seemed to be—I don't mean to give too little weight to his testimony, but simply that seemed to be the key for him, a question of substitution in the market. And this is simply not the way I viewed the unrelated business income tax and that is not the way I viewed the Disabled American Veterans.

The unrelated business income tax was passed to avoid a certain kind of evil. Now, we all know that one cannot use and ought not use, and I certainly will not use legislative history to go contrary to the express terms of a statute when they are clearly applicable to a situation.

But Congress was not so generous in defining for us business profit and the like. We have to make the decisions on our own, we the courts. And therefore in looking at a situation where you have a transaction where both buyer and seller are consenting in the sense that one controls the other, or one has significant control over the other, one is somewhat at a loss to see whether something is a profit. That is what we have been grappling with here for the last three weeks. So you go back and look at what evil there is in the market. What was Congress trying to do in 1950 or 1953 or when the [unrelated] business income tax was passed, and one comes to the frequently-asked question, "Who is Ronzoni."

Now, nobody has really satisfactorily pointed to Ronzoni for me. I have been listening for three weeks of trial and nobody came up and said, "Here, this is Ronzoni, this is the competitor that is going to be adversely affected in the manner in which Congress feared there would be adverse effects when it slapped Mueller Macaroni Company on the wrist,["] or basically said you cannot do that, you cannot use your tax exempt status to make profits.

And I am still somewhat nebulous as to who Ronzoni is, as to who is hurt, who is damaged if the members of the association on the one hand allow the association to use its group asset in order to raise funds. And I don't think—you know, the most obvious Ronzonis, or the most obvious candidates are the other life insurance companies, your Prudentials, your Mutuals of New York, and the like. And all the evidence seems to be that if only ABE charged less, if only ABE charged less and perhaps charged so little as to make no return or profit or whatever one calls it, fundraising, at all, there will be more people buying ABE insurance, for many people that would then become a better deal and it would be more likely that Prudential Insurance and Mutual of New York and the like would lose business.

So in that respect the results suggested here by application of the tax at least initially looks like a perverse result. But when one thinks out loud, what else is there? I mean is there some other organization in the market, some other Ronzoni, some other enterprise that is damaged, hurt, that suffers by virtue of the fact that this charitable type enterprise is engaging in this activity. Is the evil the Congress sought to alleviate creeping in in some fashion which is not obvious to the naked eye. And it takes another look.

And the question then is what of the organization as an intermediary, or as somebody who goes and sells the group experience for insurance companies, or somehow competing perhaps with other people who would act as intermediaries to this group, or something of that sort.

And the evidence tends to strike a couple of these hypotheses out right away. All of the evidence on both sides makes it clear that the money here came from premiums, that no matter what the flow of dollars the economic reality was that these were the members paying money to the association and not insurance companies paying the group in some fashion. The evidence of the insurance people was clear, but more telling was the undisputed evidence of all of the other witnesses, Ms. Khachadour as I recall was one of them; and quite clearly insurance companies don't manufacture money, although some of us may suspect at times they do; it comes from premiums.

I don't think this is a terribly complicated transaction, I think most people know what dividends are and that basically they come from refund of the premium and the premium came from the member. So it is difficult to construct a hypothesis that somehow the group is selling something to the insurance companies.

And you get back to the question is the group profiting from its own members. And I simply was not able to

find that it is. I find that the idea of profiting from oneself, that the idea that profit given by consent, is almost a contradiction in terms.

Now, could somebody else have stepped in, or is ABE precluding somebody from stepping in and taking advantage of some market opportunities, the sellers of macaroni, some sort of analogy of that sort?

The point is there is only one such group asset, only one group experience. It belongs to the group. I have seen no reason to think that it belongs to society as a whole or to individual members; nothing has been presented to suggest that it ought to belong to anybody but the group. And this situation is not like the purchase of macaroni, where basically only one entity can have the benefit of that and the group has chosen to make a gift of that group asset to the Endowment. And you know, perhaps other witnesses and other economists, on a different record, somebody will be able to point out to me Ronzoni in this picture, but I have tried very hard, and looking at the policies of the tax, the policies of the unrelated business income tax, I have not been able to find the evils that Congress sought to alleviate by passing that tax.

Therefore getting back to the analysis itself, there is nothing that would push back the original inclination I had, this is billed as a charitable enterprise, it is presented as a charitable enterprise, it is a group asset, it is given by [m]utual consent, members have control, one can't make a profit on oneself, I don't think. I think it is the antithesis of a profit to say that one can have control of how much profit we take, much like the suggestion I made to Mr. Dennis what would happen if all Safeway customers were allowed to vote on the prices at Safeway. The reason Safeway makes a profit is because customers don't get a chance to vote. And I therefore conclude that it is just not a business enterprise, by its structure, by

the way it is operated, by the way it is billed and by the reference to the policies of the tax, there was not profit and therefore not a business.

I have considerably greater trouble on the issue of the individual members, and as clear in my mind as the issue of the Endowment is, or at least the way it seems to me it is clear, I have still grave doubts on the question of the individual members, and I am not going to be able to resolve them today.

I have listened to both sides, and I have listen[ed] to both sides speak today, and perhaps the problem is the case has been tried and presented and certainly viewed by me largely with reference to the unrelated business income tax, to that aspect of the transaction, and in the fond hope that that would take care of the other problem as well. And in Plaintiff's view I know that it does. In Defendant's view I think, had the result been different on the Endowment case, I am sure they would have had the same view. I view them as not necessarily related. I recognize that is a much more difficult problem and one that I just cannot resolve today. I am simply going to have to go back and think about it.

I understand very well where the two parties are coming from. I think I understand this case as well as anybody here, because I have the benefit of not having the perspective of one party or another. And Plaintiff is saying the valuation of insurance to a group ought to be the net cost. That is a fair market value.

I understand Defendant's position equally well, that one looks at comparable sales and comparable transactions and that you don't look at cost of the product to determine its value. One can get into a bargain and buy something one day, buy a stock one day, say, and then it gets taken over, or there is an offering by some other company to buy out that stock and it immediately shoots up. Well, the fair market value of the stock is not necessarily what one paid for it the day before, it is what somebody else was willing to buy it for today. Those who have bought and sold on the stock market know that. I think there are inherent and difficult inconsistencies that cannot be resolved by either position and that may be unresolvable.

I recognize that the Government has done away with, or has never really quite presented the Duberstein test; and the question is not one of good heart or generosity, but I am troubled by the position taken by the Plaintiff in offering Mr. Burnett a charitable contribution. I may decide that nevertheless Mr. Burnett ought to get one, but having seen him sitting on the stand, and being convinced that he in fact bought the insurance because it was the best deal he had, I am troubled about saying that he ought to get a charitable deduction on top of everything. I simply am convinced as to him that he is buying the insurance by virtue of the fact that it is the best deal and not because he has any attachment to the Endowment's purposes or otherwise.

I am equally troubled by the position taken by the Defendant, the suggestion that these are name tags, or books or key chains capable of valuation in one market is simply not supported by this record. I think it is utter nonsense. I think there are at least 50 markets for insurance, particularly group insurance. I think one ought to take into account the basic and significant differences between group insurance and individual insurance. I think individual insurance by clearly established record is a different product, and a significantly different product. One can take it with one to one's grave or something of that sort. Certainly to California. And it is viewed, sold, marketed and considered as a different product. There are little frills you can buy with it. You can buy double indemnity and accidental death, waiver of premium; you can insure your insurability. It is yours, you can do lots of things with it. I think the subjective valuation that

people place on having an insurance plan is not [dependent] upon a membership to [sic] an organization or that it is somehow geographically limited.

So comparison with individual insurance, although not entirely irrelevant, I think is inherently misleading, and it is very difficult to account for the subjective differences that a particular consumer of insurance would feel in having his own insurance that can't be taken away from him, that has guaranteed premiums as opposed to another insurance where he has to pay membership in an organization that may or may not exist, that may or may not expel him, that may or may not be acting in his best interest, that may or may not be in the same geographic area all the time; let's say he has to move overseas or elsewhere, there are many uncertainties connected with group insurance which are simply not present to individual insurance and I find the analogy on them on the basis of this records [sic] to be a difficult one. I don't find them incompatible, entirely irrelevant, but on the spectrum of things individual insurance is much further away from center than let's say other Bar plans or other associational insurance available.

Nevertheless the point is well taken. The market consists of lots of competing products and many of them are only imperfect substitutes for another, and yet for better or worse courts must consistently make decisions on the basis of somewhat arbitrary distinctions between valuations of one item or another; the house near the end of the block as opposed to the one in the middle of the block, the house two blocks away closer to the supermarket and across the street from the school. Courts do it all the time.

What is troubling about Defendant['s] analysis is not the idea that one ought to value some very, very subjective considerations one against the other, but the idea that there is one market, and the idea that one can find

a fair market value for insurance in the United States and place the American Bar Endowment plan either within or without that market range. And that is very troubling.

I am troubled by the gentleman or lady in New York City who is a member of those two associations and who has by hypothesis in front of himself or herself the two plans, the New York State plan and the American Bar Association Plan. I cannot on the basis of this record—I could not conclude for such individual if he or she were to come to ask for a refund in this Court and I would look at that person's situation that a decision to buy American Bar Endowment insurance is other than a gift, that it was a contribution, that it was indeed the differential was paid in order not to get insurance, but in order to get whatever satisfaction one gets from contributing.

There are the two positions. Both create unfairness and both create what I view as inconsistencies. And I know both sides feel that their view of the transaction is the only one that is acceptable. I am simply saying I am enough troubled about it that I am not going to decide today. And I am going to say this much: I am not simply withholding this issue, but I am indeed undecided. I am so close to 50-50 on the issue that I cannot personally myself tell which way I would decide the case were I to make a decision at this minute. I would probably have to throw up a coin or something close to that. I don't know if that is any help to anybody. It is not nearly as much help as getting the case decided in one's favor, but there it is.

I am fairly firm, quite firm on the Endowment side of the case. As I have said before, I consider myself infallible although not irreversible, so I think everybody should have the hope, or the appropriate amount of skepticism.

I want to suggest to the parties further possibilities of settlement. I had hinted at this before today's session. I want to now propose it outright. On the one hand, I think there are basics for settling. Nobody really knows, including myself, how I am going to come out on the members. At least Mr. Rubloff empathizes with my dilemma and I hope others too. I will decide it, one way or another I will come out with it, and if nobody suggests the middle way I will have to select one of the two positions suggested, and in light of my ruling on the other case I am going to have to go back and rethink and look at the authorities cited one more time. And I figured the first case out and I will figure this one out too for better or worse, but let me suggest the possibility that settlement may not still be beyond reach.

I have made my statement on the Endowment's case. And one should not underestimate the deference that an Appellate Court will give to a trial Judge who has sat here for three and a half weeks and looked at the witnesses and considered the evidence.

On the other hand, these are big issues. And by everybody's analysis there is really not that much in dispute. If the parties after all of this want to sit down and hammer out a stipulation, I bet you it could be done. So nobody is really going to offer me the kind of deference in a case where there are two inconsistent witnesses, one says I was home with my mother and the other says I saw them stabbing the victim. It is just not that kind of case.

I will endeavor as best I can to pull together the relevant facts as I see them, but my opinions tends [sic] to be short on facts. I tend to say only the things that I consider relevant or crucial to my decision, and I think it is fair to say that the Appellate Court will be able to make up its own mind on the analysis, the analytical portion of my conclusion. So whereas I think there is good

reason for the Bar Endowment and its members insofar as the Endowment to be heartened by my decision, there is always the possibility of reversal, and I guess I don't need to repeat that again. I think it ought to be on everybody's mind.

And then there is the question of how I am going to come out on the individual members. I have no way of knowing what is really important to the parties and what is really the telling aspects of the case, whether the members' case is more important than the Endowment case or the like. This is only something that each side can determine on its own.

But as far as the Government is concerned, I promise at least as far as the Endowment is concerned, and certainly whatever I do with the members, I will write an opinion that I hope is persuasive. I will, having once decided how the case ought to appear, I will draft it in such a manner as to maximize the chances for affirmance. Let me just say there is certainly solace to be taken from the possibility of reversal, but I wouldn't count on it. I think more likely than not appellate courts in such cases tends [sic] to give some deference.

I am going to think about this case. I have about seven trials coming up, five before the first of the year, a couple more in January, and I have three major opinions in the works. Frankly, I have spent enough time on tax for a while, and particularly on the American Bar Endowment. I am going to another trial starting Tuesday. I have got speaking engagements and trials in Houston and Lord knows. I have got a trial starting between Christmas and New Year's. So I would just as soon not think about this case for a while. And in light of all that you have learned today, and perhaps for the first time you have now had your respective views scrutinized by somebo' I hope you understand understands what you all have to say. You may not all agree with everything I

said, in fact I am sure each side disagrees with some of what I said, but I do understand your case and I do in light of the maximum amount of evidence that has been presented I think have a pretty good grasp of what went on.

So try to step back from your own position, from your own view of the case and kind of view it from my perspective, and then ask yourself is there a basis for trying to work out on the one hand securing the gains already made, and on the other hand salvaging the limiting losses that might already have been suffered.

So I think you should all go home, digest it, buy the record, buy a transcript, listen carefully to what I was saying, what I was asking, what I said this afternoon, and try to figure out how I am going to decide the other aspect of the case. And if you can, you are more clairvoyant than I am. But what I propose to do is take a little while off and work on some other cases. I simply do not at this point have the time to devote further to this case and I am going to leave it in abeyance. The other cases are lined up. And I do want to give everybody a chance to have things sink in and I would then like to request one more massive and good faith effort at settlement.

What I have said today on the record is not necessarily of precedential value. My thoughts are in the transcript. They do not embody an opinion. They are known to those present, but of course they would not be binding on anybody else. Think of the consequences of an opinion, the consequences of affirmance or reversal of the opinion, and think about the one outstanding issue; and do not minimize how difficult an issue it is. Much as everybody thinks that they are right on it, I think you fairly ought to know I am not doing this in order to in a sense extort a settlement. If I could have decided the case in its entirety today I would be entirely pleased to do so. I am

not holding back just to press settlement. I simply cannot decide it today. It is unusual for me, but I always reserve that prerogative, and when important cases come along and difficult issues, issues I cannot resolve on the spot, I want to be as candid about that as I am about telling you when I have made up my mind.

Why don't we set the case for status in about three weeks?

MR. GREGORY: I take it, Your Honor, that with four remaining cases of the individuals, you are not deciding either the New York Plaintiff cases today or the other cases?

THE COURT: I am deciding the Bar Endowment case. I am not deciding any of the individual cases. Now, in a sense there is no decision today, and there is no opinion or judgment or order or anything of that sort. I have simply made the prediction of what my opinion is going to read like. I am not going to change my mind. My mind may be changed for me but I am not going to change my mind on that one. In a sense what I was telling you is what my mind looks like at this point and I have decided in my mind the Bar Endowment case, and I will eventually have an opinion that reflects many of the thoughts I gave today orally.

I am not deciding any of the individual cases. I don't think they can be separated, Georgia, New York, though perhaps it can be, perhaps what we wind up with is some geographical nightmare where people from New York are going to be better off than people from Arkansas. I would hope that is not the result I come up with. I would hope fervently that everybody thinks about the mischief that judges can do when they start trying to work their way out of what they consider to be difficult theoretical boxes, or difficult dilemmas.

I want to be candid, this is a dilemma for me. I find that aspect of the case the most difficult part. Everything

else, judgment calls, whatever, but it finally fell into place for me. I see my way clear quite well on the Endowment. It just has not fallen into place for me as far as the members are concerned. Please don't make me make any mischief. We want the law to develop in a reasonable fashion. And consider your respective interest, consider what you think you can give up, take into account what I have said and the consequences of the ruling in this case to yourselves, to the law as a whole, to other taxpayers.

It is never too late to settle. I suppose it is too late to settle once cert is denied, but should we set—can I get the agreement of both sides you will go back, digest what I have said and make one final very serious stab at settlement?

APPENDIX B

IN THE UNITED STATES CLAIMS COURT

Nos. 163-83T, 190-83T,
320-83T, 351-83T

FREDERICK D. TURNER *et ux.*,
ARTHUR M. SHERWOOD *et ux.*,
FREDERICK G. BOYNTON and
HERBERT C. BROADFOOT, II *et ux.*,
Plaintiffs,

v.

THE UNITED STATES,
Defendant.

TRANSCRIPT OF ORAL OPINION
OF CHIEF JUDGE ALEX KOZINSKI
ON DECEMBER 21, 1983

THE COURT: So be it. I will just decide the case. Now, I'm not going to have the judgment for you until well into February. In light of what my findings and my tentative conclusions are the sides can do—you know, I'm disappointed in the fact that there has been no settlement, but I have no doubt that much thought has been given, and that without knowing anything about the settlement—and I assure you, Judge Margolis has been very circumspect, has told me nothing at all about the settlement—assuming, because I know counsel from the case and otherwise that it has been in good faith on all sides.

I guess there wouldn't be any call for judges if all the litigants could agree with each other as to how they come out.

Very well. I found this to be,—first of all, I have good news and bad news. It depends on which side. I have given more thought about the part of the case, the American Bar Endowment part of the case, the part that I had decided at the time of the last meeting, and I am pleased to say I haven't changed my mind.

I feel entirely comfortable with the result, and I can tell you now with a fair degree of certainty that that is how it will, in fact, come out in my opinion. I have not started working on the opinion, but once in awhile one makes an oral ruling and is troubled by it, and looks for ways of stepping back or anything of that sort, so I will not be stepping back from what I said the last time we met.

I may be wrong, but I am happily so. I hope I'm right. I do continue in my conclusion that—

MR. RUBLOFF: Your Honor, could I inquire of the Court as to whether any findings of fact, specific findings of fact will be made?

THE COURT: Probably not. You can pick them out of what I said in my opinion. I don't think I will make specific findings. Is there something specific you would like to ask me?

MR. RUBLOFF: Well, I know in other cases it has been the Court's practice to respond to—

THE COURT: To the written questions?

MR. RUBLOFF: To the questions that were specified by the parties as representing the issues in fact.

THE COURT: I looked at this case, and it got so involved and so far from what it was that I actually saw was relevant to the case that I decided not to go down the list of everything. I just didn't think they were all that important. But if you have something that you would like to call my attention to that you think is really important that I have not resolved, by all means call it to my attention.

I may get a copy of the order and go down with all of you when this is done. I was going to do it, and after four weeks of trial things got so, in my mind, so far afield from some of the things that were in that order specified as issues in dispute that I decided not to do anything with it.

Let me go through and deal with each case, and then we can go back and answer specific questions. Was there anything in particular that you had in mind?

MR. RUBLOFF: No, Your Honor, I didn't mean to make any proposal or request, it was simply an inquiry because I was aware of the fact that in prior cases it had been your practice to respond specifically to the matters contained in, I think it is what you call the order governing—

THE COURT: Proceedings at trial.

MR. RUBLOFF: Right. I just wanted to clarify what the Court's—

THE COURT: Sometimes I do and sometimes I don't, depending on whether I think it is important, depending on whether the parties think [it] is important. I look at it, and I did look at it before the last time I met with you to see whether following down that pathway would prove fruitful, and given the fact that the case was tried by one side geared to DAV to some extent, and somewhat differently by the other side, and since I decided DAV was not really relevant and controlling in this case, because in DAV there was a commercial transaction, you know, the buyers were not related parties, and here there was a difference in that element.

I may go back, let me get a copy of the order and then I may go back and answer some of your questions. Of

course there will always be time in remand to answer some of those questions, too, and there will be remand.

In any case, the question of the four individual Plaintiffs, in a way I found was the most troubling aspect of the case, some of them because the way the case was tried by both sides much of the focus was directed on the Endowment case itself. To some extent there is value in that, because if I understand things correctly, had the Endowment lost that would pretty much have taken care of the individual Plaintiffs. Given that the Endowment has won makes it, I think, a much more difficult case to deal with individual plaintiffs.

And I, you know, had some misgivings, some of which I expressed the last time, about the perception that was conveyed, at least by some of the witnesses, that somehow there was one unitary market for insurance. In fact, it is quite clear there were many markets for insurance, geographically and otherwise. Certainly geographically there were large differences, and I was troubled by the possibility that some—and I still am—that some members of the American Bar Endowment who buy insurance may be getting a terribly good deal, and may get a charitable deduction, when in fact, this is the best deal they could get.

And I was equally troubled that a blanket rule going the other way would perhaps deprive some people who are in fact making a contribution from deduction. But then I thought about it some more and decided it is really my province to decide cases and I will leave policy to people who are paid to set policy, and I can only decide the cases that are before me, and let future cases, future lawyers, future judges, those involved in the administration of justice and the administration of income tax laws and federal regulations deal with questions of equity and equality and what not.

So I went to each individual plaintiff, and I looked to see what there was in the file or what was in the record

that would support his claim for a charitable contribution. And in trying to analyze the evidence I considered the dual payment cases, the cases that talk about making a charitable contribution while paying for something else, and I also considered the authority cited by the United States Government, and the conclusion I came to was that there must be some showing that the payment made had at least in part a charitable component.

That there must be showing that he was not entirely motivated by some other collateral economic concern. If the record did not establish that, the existence of some charitable component, I decided that that plaintiff should not prevail.

In the case of insurance the question was did somebody buy more expensive insurance than he or she, I guess he in this case, could have gotten by—did he buy American Bar Endowment insurance, which was a much worse deal or significantly worse deal than what would have been available elsewhere in the market. And I took each of the plaintiffs in order and looked at the status and what else was in the record, and in the case of Mr. Broadfoot I decided that he did not make such a showing, and I am holding, in his case, in favor of the Defendant.

Mr. Broadfoot, if I did not get my names confused, I believe was one of the gentlemen who lived in Georgia. He had ABE life insurance in the amount of $50,000, and he said that he was aware at the time he made the application, or the time he paid the check, he was aware of the fact that a portion of this payment would be used, albeit collaterally when it comes back as a dividend, but would be used to support a tax exempt charitable type of activity.

But that is not enough, at least in my reading of the law. Simply knowing that part of a payment goes to a charitable endeavor does not, in my view, render this

payment charitable if in fact the payment was entirely motivated, could have entirely been motivated by other economic concerns.

So it is perfectly consistent for somebody in Mr. Broadfoot's position to have no sympathy at all for the American Bar Endowment, although I am certain that he, in fact, did, or else he wouldn't have been here—it would have been perfectly consistent to know that a portion of the payment were going to those types of activities, and yet paid grudgingly. Pay it, but not be particularly happy about it, or not have that motivation at all, and we had at least one witness who said as much.

He said he was not upset about the fact that the things were going to the ABE, but that was not a motivating factor at all. I found nothing in Mr. Broadfoot's testimony to suggest that the charitable contribution was, in fact, motivating him to buy the insurance from the ABE. It is curious with all these plaintiffs what they did not say, given that they were on the stand and able to testify.

They did not say that they selected this insurance over cheaper available coverage that they had, or equal coverage. Certainly, Mr. Broadfoot did not. He made no indication that he didn't—and not only that, it is enough that he didn't look for the insurance, perhaps because he was so enamoured with the idea of contributing to the ABE. Really, nothing at all that would support the view that he, in fact, bought the ABE insurance at some economic cost to him, at some additional economic cost to him, in order to support American Bar Endowment.

If one looks at the Georgia life plan, and I have said already on this record I find that, Georgia Bar Association plan, and I already said on this record that I find the individual insurance to be materially different from association type of insurance, and I continue to adhere to that view. I believe that individual insurance, because

of the differences in portability, the differences in the ability to get it with or without medical examination, is a different product.

In group insurance, where everybody in the group can get it, it may be limited to in some way geographically, it may be tied to payment of some collateral membership fee, like one has to be a member of the ABA in order to be able to buy the ABE insurance, I find them to be significantly different commodities. So I look at what might have been available to Mr. Broadfoot in Georgia, and the inference is that—well, certainly there was no evidence that he, in fact, considered any other plan, but in fact, the rates were not considerably different between the Georgia plan and the ABE plan, if I remember the figures correctly.

The question of Mr. Broadfoot, as to whether he considered the ABE plan to be outrageously overpriced at the time he bought it, he said he did not, and really, there was no indication at all, certainly not enough of an indication to persuade me that he, in fact, rejected the cheaper available coverage because he felt he wanted to buy the more expensive coverage in order to contribute to the ABE.

So in the case of Mr. Broadfoot I decide in favor—in fact, now that I look I see that Mr. Broadfoot noted that the cost of the Georgia program, in fact, exceeded the cost of the ABE, the Georgia Bar plan exceeded the cost of the ABE coverage. In light of all of that, I simply cannot find that he was making a charitable contribution.

Mr. Turner. Well, let's take Mr. Boynton, who was the other gentleman who was in New York—I'm sorry, in Georgia. Mr. Boynton had a separate issue involving the Ionosphere Club. That issue was resolved in his favor when the Government proceeded and had put no evidence contrary to his testimony in any case, so on that issue Mr. Boynton wins. Mr. Boynton, if my notes

are correct here, was involved in the disability program rather than the life program of the ABE. Again, he noted that he was aware that part of his payment of the premium reflected a payment towards the American Bar Endowment's charitable activities.

There was, however, no indication as to what other coverage might have been available to him. He did say he did look at other available plans. He did not say that those were significantly less expensive, and then he bought American Bar Endowment plan at some additional economic sacrifice to him in order to make a charitable contribution.

As far as this record reflects Mr. Boynton, too, seems to have gotten—at least there is nothing in the record that suggests other than that Mr. Boynton took the best deal he could get on the market. In that case, I found the motivation for purchasing insurance was entirely economic, and that his entire motivation is covered by economic interest, and cannot be deemed, any portion of it can be deemed to be charitable.

Mr. Turner. He is from New York. The interesting point in his testimony is that he says he is not a member of the New York State Bar Association. I must have been under a misapprehension of fact at some point in the proceedings, because I did not recall this, and I had thought that New York like some other states must have an integrated bar, and that being an attorney in New York State would make one automatically a member of the New York State Bar Association. Of course, that is not true in all states, and apparently Mr. Turner's testimony is that that is not true in the State of New York.

I surmise from this that the New York State Bar Association is a voluntary association. It is a voluntary association of which Mr. Turner is not a member, or was not a member at the time he testified, and I don't think he was a member—I can't tell from his testimony,

he says he was formerly a member, it is not clear when, but I gathered from what was said that he was not a member in the tax years in question.

I find Mr. Turner's case just a little bit more difficult because apparently he had had some other insurance, and it is not entirely clear why he switched. It certainly would be consistent to say he might have switched to the ABE plan because he wanted to make a charitable contribution, and he might have switched from a less expensive to a more expensive plan, but he doesn't say that.

He said that he had policies with Provident Mutual and Drexel Life Insurance, it would have been easy for him to say that those plans or establishing those plans were cheaper, and he was doing what would be counter-intuitive moving to a more expensive plan from a cheaper one, or give some other indication that, in fact, he chose ABE other than for the fact it was the best deal in the market. The burden is on the plaintiff. It was not established in the case of Mr. Turner.

I note that he was not a member of the New York State Bar Association, so he could not have taken advantage of the favorable rates available under that plan from New York Life Insurance Company. Those rates, from what the evidence shows, were more favorable, at least for some age brackets. It is not clear to me why Mr. Turner was not a member, what the cost of membership would have been, what other implication there would have been for this membership, so it is certainly impossible to tell whether—on this fact, as to whether whatever cost would have been associated with becoming a member or obtaining membership in the New York State Bar Association, when added to the premium he would have paid for the insurance would, in fact, have made the New York State Bar insurance, where would that be in relation to the ABE.

There is no other evidence on the record that I could see relevant which would suggest other than an entirely economic motive on Mr. Turner's part. Again, the fact that [he] knew that part of his premium was going to these charitable endeavors of the ABE is not sufficient, at least in my view of the law.

The most interesting and difficult case involved Mr. Sherwood, and again I just decided these one case at a time, and I suppose with 50,000 or 75,000 members of the ABE might come trotting in here, I don't know what to say. These are the cases I have before me.

I note, first of all, that he had both life and dependent insurance. As to the dependent insurance, I—again, this is a voluminous record and I did not go hunting through it at great length, but as far as I can tell there was really nothing in the record to show comparison of rates available for the dependent insurance. There was no indication affirmatively from Mr. Sherwood that he bought dependent insurance at great economic, or a greater economic sacrifice to himself in order to benefit the ABE.

So far as the dependent insurance is concerned, I find in favor of Defendant and against the taxpayer.

Now, on the life insurance, what makes this case interesting is that Mr. Sherwood was a member of the New York Bar Association. According to his application for ABE insurance Mr. Sherwood was born in 1939. This is Exhibit No. 353 in the record, and I have no reason to doubt its accuracy. So that means that in 1979 he reached his 40th birthday, in 1980 he would have reached his 41st birthday—in 1980 he would have been 41, in 1981 he would have been 42.

So we have here an individual who was, in fact, eligible for the New York Bar plan, and for whom in the age bracket of 40 to 44, which he would have been in at least for the most part of those three years, the New

York plan would have been somewhat cheaper for the first year, and significantly cheaper for the second or additional years. Apparently the New York plan, there was a high premium in the first year.

So that posed an interesting question, whether the availability of this plan alone, the availability of what I consider to be an equivalent product in the market, in that particular market, would have been a sufficient indication that another product was considered, was rejected, and therefore, the inference ought to be drawn that the taxpayer was choosing a more expensive and less advantageous economic product, and therefore, was doing so for charitable purposes.

That case gave me trouble. It also gave me trouble on —Mr. Sherwood's case also gave me trouble on another count. He had $320,000 worth of insurance, with $20,000 of that apparently being with the American Bar Association, and $320,000 is a fairly odd amount, so there is somewhat of an inference that he bought $300,000 insurance somewhere, and then maybe $20,000 from the ABA or the ABE.

Unfortunately, he really don't [sic] say anything of that sort. I looked, and tried to find some indication as to what was going on in his mind when he bought or obtained the insurance. Apparently he bought the insurance in the early '70s and then raised the coverage from $8,000 to $20,000 in 1978. He does state that he was aware that a portion of the payment that he made to the Endowment was for, or would go for charitable purposes. But nowhere does he really say that he could have gotten the extra $20,000 of insurance more cheaply from his insurance company, or indeed, from the New York Bar Association, and that he rejected those in order to make a contribution.

In fact, apparently he was a member of the New York Bar life insurance program, and rejected that, let the

coverage lapse later. It is not explained as to why he did that.

It is a close case in my mind. In order to have Plaintiff prevail, at least in my mind, it would have to be established that, in fact, an equivalent product was available in the market at a significantly lower cost, and I think in this case that was established.

I think it must also be established that the product was known to the taxpayer, and that an affirmative decision was made to reject the lower priced product, and that affirmative decision was based on some desire to make a charitable contribution, and although I find this case close, I decided against the taxpayer and in favor of the Defendant.

There are things that Mr. Sherwood could have said that he did not about his decision to reject or discontinue his coverage under the New York State Bar plan, there were things he could have said as to what the expense would have been of buying an additional $20,000 of insurance privately, if indeed, that was available, which I assume that it was.

Finally, although I don't think there is anything wrong with this, I think some weight has to be given to the fact that American Bar Endowment insurance was marketed aggressively, and with many indications in the literature that this was a good deal, and a good buy, and I don't mean to suggest that there is anything at all wrong with that.

Given what I have said, the nature of Endowment's endeavor was, and that was that it was a contribution, it was not a business. It was a way for the members to make this economic good available as a group for conducting charitable purposes. I think it was incumbent upon those running the Endowment to try to run it in a way which would maximize, I guess one would call the

revenues, or maximize the benefit to the Endowment from this nice advantage that was provided by the members.

So I think there is nothing wrong at all with advertising that is aggressive, and in some ways suggested this may be the best deal in the market, and indeed, for many people, from the best I can tell, across the country it may very well have been a very good deal, indeed, and perhaps the best deal. It may, in fact, not have been, and I'm not sure that they ever claimed for it to be the best deal in all circumstances, but I think there was enough in the literature where if Mr. Sherwood did not have the two plans side by side, and could not see the exact rates for his particular age group, he might not be aware of the fact that he could have gotten an extra $20,000 of insurance from the New York Bar Association perhaps less than he could have with the ABE.

I think it is a leap of faith which is one I'm not going to take without benefit of testimony from the Plaintiff. If Plaintiff wishes to tell me that he has considered a lower cost alternative, rejected it because he wanted to make a contribution, that may very well be a different case. In fact, in my view of the law I would, again depending on the facts of the case, probably rule in favor of the Plaintiff if such a showing were made. But a showing must be made by the Plaintiff and I found in the case of all four Plaintiffs that the showing was simply not made.

Now, I understand why the showing might not have been made. These are test cases, and I suppose a broader victory is always better than a narrow one, a victory where—I am just surmising, just assuming this is what might have happened—that if less is [said] that is fact specific, and these plaintiffs survive that would, of course, be of much greater precedential value one way or the other, in resolving what is a knotty, knotty legal issue and will affect the conduct of the Endowment and the

collection of revenue laws for many years in respect to many people.

I wish I could have come up with a more creative and less fact specific decision in these cases, but from my reading of the law I simply can't. I will not exclude the possibility that under the right set of fact[s] the Plaintiff could show that the purchase of insurance had a charitable component, and in fact, was motivated by more than economic desire to buy insurance. I think the authorities compel that. But on the other hand, I cannot say that once it is established some of those dollars go to charity under any and all circumstances, a portion of the payment was charitable, without assistance from above—just one or two floors above—I don't think I can take either of those positions.

Now, Appellate Courts and Members of Congress and those in the Internal Revenue Service have to look at the broader picture, or may have to look at the broader picture. My responsibility is to decide the cases I have here, and that is where I come down.

So after a truly careful review of the situation of the four plaintiffs, and I have given it considerable thought, I find that the required showing was not made for any of them, except for the one Ionosphere matter which we can put aside, and that I will rule in favor of the Defendant.

Now, do I have my order governing proceedings at trial? Do you have a copy? Is there something in particular you want to ask me? I have copies here you can look at. Someone made some notes, and you know, I don't remember why. I don't think it was me, probably somebody else. I mean, there are little yesses and nos and whatever, it might have been a law clerk. I'm willing to let you look, and don't take whatever is there in terms

of notes as a—I don't know what the notes are, so just ignore them.

As you go through, I will answer any questions that you think are not clear by now, or that—just take your time and go through it, and I will be happy to answer them. I will also use this in writing an opinion, to make sure I cover whatever points I cover or need to be covered.

If you want, I can go through and answer what I can answer. I mean, some of them seem fairly easy, some of them seem complicated and pointless. I don't mind going through and trying to answer.

Maybe we should just go down the list one time and see what we have.

On page 3, Paragraph V, Issues in Dispute.

"The parties agree that the ultimate questions of fact and law in this case are:

a. As to the individual plaintiffs, did they make charitable contributions to the Endowment during the taxable years by virtue of the Endowment's receipt of dividends and experience credits and, if so, in what amount?"

I think I answered that question. It is, as to each individual plaintiff, that they did not.

"b. As to the Endowment, did it have unrelated business taxable income arising from its receipt of dividends and experience credits during the taxable years and, if so, how much?"

I have answered that question as no, it did not have unrelated business income.

Now we get to the difficult questions, okay?

"Subsidiary Questions, A. 1. Did the individual plaintiffs, in making their premium contributions to the Endowment, make 'dual payments' part as a contribution

of dividends and experience credits to the Endowment for charitable uses in the field of law, and part for insurance coverage?"

That is a very difficult question to answer. It is quite clear that the payments that they actually made were, in fact, partially used to buy insurance, and partially by way of the dividends then used to support the charitable purposes of the Endowment. I'm not sure whether anything more is implied in the question in the concept of dual payments.

Does either side wish to speak to that?

I have said that that does not necessarily apply to a charitable contribution. I do recognize that part of each, and I do find that part of each check paid, at least with these individual plaintiffs, that each check contained—well, that each check was used in part to pay for insurance, and in part eventually through dividends to pay for the Endowment's charitable purposes. Is that satisfactory or clear?

MR. THROWER: May I make a brief comment on that, Your Honor?

THE COURT: Of course, Mr. Thrower.

MR. THROWER: But I haven't seen in your comments or heard in your comments a reflection or comment on our position that the group, by a group decision, has been making a group gift, that it could by a group decision change that in any year, and that where the group participates in the group decision in making a contribution equal to the difference between what they pay and what they could have paid had they made the decision to get the full economic benefit for themselves, that that constitutes the measure of the group gift, and the allocation of it made on an objective basis, and rather than on a subjective basis, would follow what we have done, what the Endowment has done, and what is customarily done under Section 61 and under Section 79.

THE COURT: Well, I accept that theory, and to my mind it brings one so far as to say this is not a business, and therefore, Endowment is not subject to a regular business income tax.

The problem is that by that argument every member of the Endowment makes a contribution, whether they buy insurance or they don't buy insurance. That those who do not buy insurance from the Endowment are nevertheless making the contribution, and that is the economic opportunity of buying—that they forego in having the much cheaper insurance available to them, causing them perhaps to go out and buy—

MR. THROWER: That is certainly true. They make a sacrifice, each member of the American Bar Association, and thereby a member of the Endowment. Each member who does not have the insurance makes the sacrifice. Only the insured members actually pay money which constitutes what we assert is a charitable deduction.

So the sacrifice of the others is essential in order to permit the ongoing program, but it is only the insured members who paid the money, and that entire group of people, whether they are high risk—they might be quite high risk, they might be quite low risk—nevertheless, as a group have the opportunity of getting the insurance at the low cost without any charitable element written into it.

This was the concept that we undertook to reflect, rather than the subjective approach of looking at each member, which I don't think was really advocated by either party, and as we indicate I believe in the earlier filings, it has generally been disapproved both by the Courts and by rulings of the Internal Revenue Service in favor of the objective approach, as is followed under Section 61 and 79, where—

THE COURT: Well, Section 79 is a specific statutory provision, which is a problem—

MR. THROWER: It is specific, simply reflecting this general principle, however.

THE COURT: —that Congress has addressed.

MR. THROWER: That's right.

THE COURT: I am just not able, Mr. Thrower, to —perhaps a case by case approach is not appropriate, and in that case, I simply would rule for the Defendant. I view the question of whether something is a business as something that can be made as a group decision. I don't view the question of whether one makes a charitable contribution as a group decision. That is an individual decision, and the majority of the members of the Endowment cannot make that for the minority.

They can certainly keep them from getting an economic benefit by making a group decision as to what the rates are going to be, but the idea of being forced to make a gift goes contrary to my conception of what a charitable contribution is. I remember Mr.—I don't know why I always forget his name, he was the gentleman with the cane—

MR. WATKINS: Mr. Burnett, Your Honor.

THE COURT: Mr. Burnett, and he paid more for the insurance than he would have paid, but apparently he got the best deal he could, and the fact that he was a member of the group, the majority of which chose to make a charitable contribution, I just don't think that that made him a charitable contributor. He was buying insurance, the best deal he could get, and without—

MR. THROWER: As to Burnett, our position would be that as a member of the group the Burnetts are entitled to participate in this group gift in the same way as others. If they did not participate, then the par-

ticipation of those with an average risk or better than average risk, their participation in the gift would be larger, because the group gift remains the same, but because the group itself could in any year by a group decision reduce the net cost for every member of the group, including the Burnetts, it seemed to us that each member should participate.

Otherwise, if you went to a subjective position on that basis, those in good health and better risk would have a great part of this group gift when you eliminated the Burnetts in the high risk.

THE COURT: Mr. Thrower, I understand your argument, I really do. I simply don't find the model classification. It may be up to the Court of Appeals to come up with—

MR. THROWER: Well, we do appreciate your attention to it.

THE COURT: I understand well enough, and I do find it persuasive in the context of whether this is a business or not. I think that one can as a group make a decision not to operate something as a business, to allow high premiums to be charged voluntarily, and that that does not then render what the revenues, the net revenues as being profit. That far I am willing to go. This concept of a group gift, I just don't think we have a model for it, Mr. Thrower. I think this would be the first case. We would have to resort to something like the Section 79 tables, which is something Congress specifically thought about and legislated, and I like to think of myself as fairly daring and imaginative, but my daring and my imagination has boundaries.

I'm willing to make all of the findings you wish to set up the issues for appeal. I think these are important issues, and obviously they are going to be decided on appeal, and you have my sympathy. I simply have to

follow the law as I see it, and with appropriate limitation of my discretion given that I'm a trial judge and not an appeal judge.

For what it is worth, I recognize that all of the facts you have stated, or all of the things you have presented are, in fact, true. The Endowment could have set the rates lower, it set rates higher—and in fact it is required from an earlier decision—it sets rates higher by a democratic majority process which could have been changed by—I specifically find could have been changed from year to year if there [were] an impetus for it.

I found that there is no reason to believe that the American Bar Association processes are such that they would not be susceptible to democratic change. On the contrary, I would expect they would be, and that, in fact, by consent of the majority, and probably overwhelming majority of the members, this enterprise has been run in a non-business fashion in a way which would be to the general detriment of the group as a whole for the benefit of the association.

Equating that into a group gift for purposes of getting a charitable deduction, I just cannot take it that far.

MR. THROWER: That is where we part, yes. But we understand your position. Thank you, Your Honor, we do appreciate your attention to the case, we know you have given it a lot of thought.

THE COURT: I was going down the list. If there is anything else that needs to be addressed—let's see, item A. 2. on page 4:

"Is the quid pro quo or private financial benefit received by the insured members from their participation payments properly measured by the net cost of the insurance (gross premiums less dividends or experience

credits) plus related expenses or is it measured by the gross premium paid to the insurance companies?"

I never understood that question. Does anybody want me to answer that question? I will try to bisect it for you—I mean, is anybody—Mr. Rubloff?

MR. RUBLOFF: Your Honor, I have the uncomfortable feeling that perhaps I have prodded the Court into responding specifically at this point in time to these questions, when I really didn't intend—

THE COURT: I'm not going to go down and make specific findings of fact, I'll write an opinion, so if there are specific points you want me to hit, you want to be sure that I hit, I think this is the time to ask me. Now, I might cover them in any case, but I might not.

MR. RUBLOFF: Well, Your Honor, my question is that the Court has in the course of its comments on the resolution of the various cases effectively resolved all of the disputed issues of fact, and I find it somewhat troublesome to impose upon the Court now the burden of having to respond to two separate sets of questions posed by the parties, each of which would understandably be posed in such terms as to perhaps favor their respective positions, or to generate an answer to their liking.

So for the Government's part, I am perfectly content if the Court would prefer to defer making any findings at this time and would simply incorporate its findings in its opinion, with the awareness that the parties are interested in the resolution of the subject matter raised by each part[y's] questions.

THE COURT: That's fine with me. I mean, I don't understand all of the questions, and maybe if I get back into it I would just as soon not go through it. So I take it you are equally unhappy with the case by case approach as Mr. Thrower is?

MR. RUBLOFF: Yes, Your Honor. I feel that you have correctly stated the law with respect to the resolution of the individual plaintiffs' cases.

THE COURT: No, my question was, I assume you are equally unhappy about the case by case approach? Mr. Thrower seems to think that that would be unworkable. I think it is unworkable.

MR. RUBLOFF: Well, I don't know if it is appropriate for me to express my personal opinion. I think you have properly stated the law with respect to the individual cases, and I think you have properly applied the law to the facts of those particular cases.

THE COURT: But you understand, Mr. Rubloff, when I come out with the writing I will allow for the possibility that 75,000 members can come in here and make a case that they made a contribution, and if they make that showing, if I'm correct in my ruling, they will win.

MR. RUBLOFF: I understand that, Your Honor.

THE COURT: I don't know how happy you are with that.

MR. RUBLOFF: Well, I don't think I'm unhappy, this is really irrelevant.

THE COURT: It doesn't thrill me.

MR. RUBLOFF: I don't think that my happiness is really relevant. I think my function is to ensure that the law is properly applied, and I do believe that is the case here, and we will just have to take each case as it arises.

THE COURT: Well, I have had three trials since this case finished. I have a two-week trial in January, so don't look for anything before February. I have things to do and places to go, and I do think the case is important and needs to be resolved, and I will write

something because obviously many of the issues, at least some of the issues are—and I will try to do as fair and as clear a statement of what I'm deciding as possible so as to give the Appellate Court an opportunity to reverse it or whatever. I'm not pulling any rabbits out of the hat, I'm trying to be mindful of the position of both parties, and include in my statement of facts as much as I think the parties would want and need in order to make their case on appeal. No doubt the case is going to go on appeal.

I should say though that what I have said here on the record, and what I said the last time on the record, are my findings, and if anything is not included in the opinion it should be—if anything I have stated on the record is not included in the opinion, that should be viewed as a finding of fact, and can be used for purposes of appeal.

Let me now for the last time, and this is, I think, the last time we're going to probably meet before I issue an opinion, let me encourage the possibility of settlement. I know people have tried, you know a little bit more now. I have no idea what went on before. You have a little bit more, pieces of information, and since nothing is going to be forthcoming from me, at least until February, I just cannot do it, it is simply not possible, go back and reflect, factor in additional information and don't be bashful.

There is plenty of room for me to be wrong on both issues. I think this is a difficult case, I think this is an unusual case, and I think it is a case where the outcome on appeal is highly in doubt. So now you know a little bit more.

You know, I am only sorry I was not able to come up with something in the case of the individual plaintiffs that I could live with and that would take care of things in a more blanket fashion. I am not terribly happy

about this way of resolving the case, but I guess I did the best I can, and let people with greater authority to do more.

I would suggest, on the basis of what my comments have been, and on the greatest likelihood that I will not change my mind, and I think it is very clear I will not change my mind, I would like you all to work out a stipulation with the amount of judgment in the Endowment case, because my opinion will require you to file one, because I assume nobody is going to want me to go through the ledgers and figure out the dollars and cents. Yes?

MR. GREGORY: It has been stipulated, Your Honor.

APPENDIX C

SEC. 170. CHARITABLE, ETC., CONTRIBUTIONS AND GIFTS.

(a) *Allowance of Deduction.*—

(1) *General Rule.*—There shall be allowed as a deduction any charitable contribution (as defined in subsection (c)) payment of which is made within the taxable year.

* * * *

(c) *Charitable Contribution Defined.*—For purposes of this section, the term "charitable contribution" means a contribution or gift to or for the use of—

* * * *

(2) A corporation . . . —

(A) created or organized in the United States or in any possession thereof, or under the law of the United States, any State, the District of Columbia, or any possession of the United States;

(B) organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes . . . ;

(C) no part of the net earnings of which inures to the benefit of any private shareholder or individual; and

(D) which is not disqualified for tax exemption under section 501(c)(3) by reason of attempting to influence legislation, and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of any candidate for public office.

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